Non-technical summary for 'Does Monetary Policy Affect Non-mining Business Investment in Australia? Evidence from BLADE'

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Business investment is a key driver of economic growth. When investment is strong, workers have access to more capital and equipment, making them more productive and able to contribute to stronger productivity growth. Business investment is also thought to be an important driver of economic cycles and stimulating business investment is one of the key mechanisms through which monetary policy is thought to work.

However, non-mining business investment in Australia was fairly weak over much of the 2010s, despite declines in interest rates and moderate economic growth. While several explanations have been put forward, one potential explanation is that monetary policy is not very effective at stimulating business investment, or has become less effective over time.

Against this background, it is important to better understand how and whether monetary policy affects business investment. As such, this study examines the effect of monetary policy changes on non-mining business investment using a variety of national and firm-level investment data. This allows us to explore both the aggregate effects of monetary policy, as well as the channels through which monetary policy affects investment. We find that monetary policy affects investment in line with the predictions of economic theory.

Key findings

- Increases in interest rates lead to less investment, both by lowering the number of firms investing and the amount of investment done by those that do invest.
- Young and old firms have a similar response to changes in interest rates. This suggests that declines in the rate of firm entry seen over the past decade, which led to fewer young firms in the economy, is unlikely to have made monetary policy less effective at influencing investment.
- Small and larger firms' investment responds similarly to monetary policy.
- Evidence from the United States suggests the very largest firms are more responsive to monetary policy and that declining interest rates over the 2010s disproportionately contributed to their growth relative to smaller firms, weakening competition in the economy. This does not appear to be the case in Australia.
- Firms that are financially constrained or more dependent on external financing are more sensitive to monetary policy changes. This suggests that monetary policy in part affects investment by loosening or tightening firms' access to finance.
- Increases in interest rates cause firms to lower the amount of investment they expect to do in the future. However, it affects their actual and expected investment simultaneously, indicating that firms' expectations reflect current conditions rather than anticipated future conditions.